Accounting for the experience variance from non-distinct investment components under the amended paragraph B96(c) of IFRS 17

Background

IFRS 17:B96(c) has gone through a number of revisions during the deliberations that considered the amendments of IFRS 17 and the final wording in the June 2020 Amended IFRS 17 text is as follows:

B96 For insurance contracts without direct participation features, paragraph 44(c) requires an adjustment to the contractual service margin of a group of insurance contracts for changes in fulfilment cash flows that relate to future service. These changes comprise:

(a) experience adjustments arising from premiums received in the period that relate to future service, and related cash flows such as insurance acquisition cash flows and premium-based taxes, measured at the discount rates specified in paragraph B72(c).~~;~~

(b) changes in estimates of the present value of the future cash flows in the liability for remaining coverage, except those described in paragraph B97(a), measured at the discount rates specified in paragraph B72(c).~~;~~

(c) differences between any investment component expected to become payable in the period and the actual investment component that becomes payable in the period. Those differences are determined by comparing (i) the actual investment component that becomes payable in the period with (ii) the payment in the period that was expected at the start of the period plus any insurance finance income or expenses related to that expected payment before it becomes payable. ~~measured at the discount rates specified in paragraph B72(c); and~~

This wording was finally approved in May 2020, only a few days before the publication of the amended text of IFRS 17. The IASB Staff paper on the amendment included a statement to explain the intent of the amendment and the rationale for putting through a change (emphasis added):

7. Between the beginning of the period and the unexpected payment or non-payment of the investment component, the investment component will be affected by the time value of money and may be affected by financial risk and changes in the time value of money and financial risk. Those effects might be as expected at the beginning of the period, or might differ from that expected at the beginning of the period. In either case, the effects should be recognised as insurance finance income or expenses, and should not adjust the contractual service margin. The amendment proposed in the 2019 Exposure Draft Amendments to IFRS 17 was intended to clarify that treatment of these effects.

8. However, feedback has indicated that the wording in the Exposure Draft is confusing. The staff therefore recommend a change to the wording so that the intention is clear.

In spite of these clarifications and the amendment, there remain questions on how to apply IFRS 17:B96(c) which will impact the timing of profit or loss emergence over time as a result of different amounts of insurance revenue and insurance finance income or expenses being measured in each period.

Accounting question

Is the amount described in IFRS 17:B96(c) from the experience variance arising from non-distinct investment components becoming payable reported entirely in the insurance finance income or expenses line item?

Fact pattern

- An entity sells a group of insurance contracts on 1/1/2020, with contract term of 2 years. A total single premium of CU 400 has been received upfront. Policyholders have the option to withdraw a specified amount at any time. The amount that can be withdrawn in total is CU 400, and is classified as a Non-distinct Investment Component ("NDIC"), being the amount that is considered as being **re**payable [emphasis added] to the policyholders under all circumstances.
- The reporting frequency for the entity is annual with reporting date on 31/12.
- The expected NDIC outflows at inception are as follows:

	01/01/2020	30/06/2020	31/12/2020	30/06/2021	31/12/2021
Undiscounted value (CU)		50	150	50	150

- The discount rate is 5% per annum, resulting in the present value of the NDIC at inception being CU 374.18[1]
- The CSM at inception is CU25.82=400-374.18, expected to be earned equally over 2 year period (CU12.91 in each year).
- Actual NDIC paid during 2020 reporting period, and the timing of payment is as follows:

	01/01/2020	30/06/2020	31/12/2020
Nominal/undiscounted value expected at inception (CU)		50	150
Actual paid (CU)		0	300

- CU 50 was expected to be paid on 30/06/2020, but 0 was actually paid on this date. CU 150 was expected to be paid on 31/12/2020, but CU 300 was actually paid on this date.
- The actual payment during the period is CU 100 (300-50-150) more than the expected amount to be paid.
- As a result of this experience adjustment, the entity re-estimated the future fulfilment cash flows on 31/12/2020 as follows:

[1] CU374.18=50/(1.05)^0.5+150/(1.05)+50/(1.05)^1.5+150/(1.05)^2

	Present value	30/06/2021	31/12/2021
Balance as at 31/12/2020 as estimated at inception, CU	191.65[2]	50	150
Re-estimated at 31/12/2020, CU	95.24[3]	0	100
Change in estimated fulfilment cash flows (resulted from Experience variance)	-96.41	-50	-50

- All other cash flows (including those from insurance coverage) / Risk Adjustment for non-financial risk ("RA") etc. are ignored for simplicity.
- Total nominal amount to be repaid to policyholder is CU 400, and the total amount does not change because of the experience adjustment. This means the measure of the amount of NDIC to be paid is only affected by the Time Value of Money ("TVOM").
- At inception, all the contracts are expected to be derecognised by 31/12/2021.
- No actual contracts were derecognised at 31/12/2020, even though some policyholders withdrew their investment component balance earlier than expected, insurance coverage still goes on.
- For simplicity, Contractual Service Margin ("CSM") is amortized on straight-line basis. In practice, CSM amortisation is based on coverage units, and will be adjusted by the change in both insurance and investment coverage during the period of service.

The amounts quoted in IFRS 17:B96(c) are:

(i) the actual investment component that becomes payable in the period
(ii) the payment in the period that was expected at the start of the period plus any insurance finance income or expenses related to that expected payment before it becomes payable

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[2] CU191.65=50/(1.05)^05+150/(1.05) This is the present value of investment component repayable in 2021 based on original expectation at beginning of 2020, adjusted for the time value of money for one year at 5%.
[3] CU95.24=100/1.05 the revised present value based on new repayment expectation.

<u>View A – The entire amount from IFRS 17:B96(c) is reported as Insurance Finance Income or Expenses ("IFIE") and it does not adjust the CSM.</u>

Supporters of this view argue that the NDIC is defined as an amount that is repayable to the policyholder under all circumstances, (and in this fact pattern, there is no financial risk associated with the amount of NDIC to be repaid). Given the entire difference, both the:

- experience adjustment in the period, and
- the change in estimate of NDIC fulfilment cash flows caused by the experience variance

arise solely from difference in the timing of NDIC expected to be repaid and timing of NDIC actually paid, hence the combined difference should be reported as IFIE.

A footnote has been added to IFRS 17 BC235 where it states:

"Paragraph B96(c) of IFRS 17 requires changes in fulfilment cash flows that arise from differences between any investment component expected to become payable in the period and the actual investment component that becomes payable in the period to adjust the contractual service margin. In June 2020, the Board amended IFRS 17 to specify that paragraph B96(c) of IFRS 17 does not apply to insurance finance income or expenses that depict the effect on the investment component of the time value of money and financial risk between the beginning of the period and the unexpected payment or non-payment of the investment component."

Therefore the resulting total change does not adjust the CSM (both in the accounting period and in the future), because it is 100% related to TVOM, hence it should be reported as IFIE. The total of such change accounted in IFIE is CU 3.59.

Experience adjustment (adjust IFIE)	CU 100.00
Change in estimate of NDIC fulfilment cash flows caused by the experience variance (adjust IFIE)	CU -96.41
Resulting total change accounted as IFIE	CU3.59

Supporters of this view consider the amounts quoted in IFRS 17:B96(c) to be as follows:

(i) the actual investment component that becomes payable in the period = CU 300

(ii) the payment in the period that was expected at the start of the period plus any insurance finance income or expenses related to that expected payment before it becomes payable = CU 200 + CU 96.41 [the payment in the period that was expected at the start of the period] + CU 3.59 [any insurance finance income or expense related to that expected payment before it becomes payable]

thus resulting in no adjustment to CSM. Additionally, supporters of this view also argue that IFRS 17:B96(b) while relevant to all changes in present value of fulfilment cash

flows in liability for remaining coverage, excludes changes specified in IFRS 17:B97(a) which relate to the effect of time value of money and financial risks. Because they consider all changes in NDIC as relating to the effect of time value of money and financial risks, they consider all changes in NDIC as excluded from IFRS 17:B96(b) adjustment.

View B – The amount from IFRS 17:B96(c) adjusts the CSM and IFIE. However, the IFIE adjustment only captures the TVOM of NDIC at the beginning of the period and the rest adjusts CSM.

Supporters of this view argue that IFRS 17:B96(b) deals with change of estimates of fulfilment cash flows in all cases, including for the circumstances described in IFRS B96(c). The new text of IFRS 17:B96(c) deals with the experience adjustment of NDIC. Thus, the total of such change accounted in CSM is CU 3.59.

Experience adjustment (adjust CSM)	CU 100.00
Change in estimate of NDIC fulfilment cash flows caused by the experience variance (adjust CSM)	CU -96.41
Resulting total change accounted for as an adjustment to CSM	CU3.59

Supporters of view B argue that the changes in estimate of fulfilment cash flows for future periods follow IFRS 17:B96(b). They argue that IFRS 17:B96(c) only deals with experience variance within the period, by making reference to Staff Paper AP2A from the May 2020 IASB meeting.

Paragraph 5 and 6 from Staff Paper AP2A from the May 2020 board meeting state the effect of IFRS 17:B96(c), before discussing in paragraphs 7 and 8 the amendment proposed in the ED and the effect of the final proposed amendment:

5. Paragraph B96(c) of IFRS 17 sets out requirements for the effects of investment components unexpectedly paid or unexpectedly not paid. For example, it requires an entity to determine whether an investment component that was paid in a period was expected to be paid in that period. If it was not expected to be paid, there will be two effects:

(a) the unexpected payment in the period; and

(b) a reduction in the expected cash outflows in future periods.

6. Paragraph B96(b) of IFRS 17 requires the effect described in paragraph 5(b) of this paper to adjust the contractual service margin. Paragraph BC235 of the Basis for Conclusions on IFRS 17 explains that the Board did not think it would provide useful information for a gain or loss to be recognised for the effect described in paragraph 5(a) of this paper and a corresponding decrease or increase in the contractual service margin for the effect described in paragraph 5(b) of this paper. Hence, paragraph B96(c) of IFRS 17 requires the effect described in paragraph 5(a) of this paper also to adjust the contractual service margin.

Supporters of this view consider the amounts quoted in IFRS 17:B96(c) to be as follows:

(i) the actual investment component that becomes payable in the period = CU 300

(ii) the payment in the period that was expected at the start of the period plus any insurance finance income or expenses related to that expected payment before it becomes payable = CU 191.65 [the payment in the period that was

expected at the start of the period] + 8.35 [any insurance finance income or expense related to that expected payment before it becomes payable]

With a resulting adjustment to CSM of 100. They would argue that the changes in NDIC fulfilment cash flows of CU (96.41) that relates to the experience variance is actually excluded from the experience variance and it should instead be part of the amounts under IFRS 17:B96(b) thus resulting in a net adjustment of CU 3.59 to CSM.

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The table below summarises the two views:

As at the end of 31/12/2020	View A	View B
Expected settlement CU 200 vs actual settlement of CU 300	Adjust IFIE = 100	Adjust CSM = 100
Change in PV of future NDIC payments triggered by the experience variance only (no change in future assumptions for the residual NDIC yet to be paid is associated with this amount) (Revised PV of NDIC at end of 2020 CU 95.24 vs Expected PV of NDIC at end of 2020 CU 191.65)	Adjust IFIE = (96.41)	Adjust CSM = (96.41)
Net impact of above on CSM	-	Adjust CSM 3.59
Net impact of above on IFIE	Adjust IFIE =3.59	-
TVOM component (IFIE on NDIC before above changes for FY 2020)	Adjust IFIE = 17.47[4]	Adjust IFIE = 17.47
TVOM on CSM (adjust Dr IFIE and Cr CSM)	Adjust IFIE =1.29 [5]	Adjust IFIE =1.29
Total IFIE	22.35	18.76

P&L comparison between view A and view B:

CU	View A			View B		
DR/(CR)	2020	2021	Total	2020	2021	Total
Insurance revenue	(13.56) [5]	(14.23)	(27.79)	(11.76)	(12.35)	(24.11)
IFIE	22.35	5.44	27.79	18.76	5.35	24.11
P&L	8.79	(8.79)	-	7.00	(7.00)	-

Since the experience adjustment and the change in fulfilment cash flows are adjusted in IFIE under View A, the pattern of CSM amortisation remains unchanged and it results in higher CSM balance when compared with View B. This is because the early settlement of NDIC results in higher TVOM impact under View A.

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[4] CU17.47=391.65(PV after 1 year)-374.18 (original PV at inception), where CU391.65=50+150+191.65

[5] CU1.29=25.82*0.05, the CSM before allocation is 27.11=25.82*1.05. Half of CSM allocated to revenue in year 1 is CU13.56=27.11/2

Appendix – Technical references

IFRS 17

44 For insurance contracts without direct participation features, the carrying amount of the contractual service margin of a group of contracts at the end of the reporting period equals the carrying amount at the start of the reporting period adjusted for:

(a) the effect of any new contracts added to the group (see paragraph 28);
(b) interest accreted on the carrying amount of the contractual service margin during the reporting period, measured at the discount rates specified in paragraph B72(b);
(c) the changes in fulfilment cash flows relating to future service as specified in paragraphs B96–B100, except to the extent that:
   (i) such increases in the fulfilment cash flows exceed the carrying amount of the contractual service margin, giving rise to a loss (see paragraph 48(a)); or
   (ii) such decreases in the fulfilment cash flows are allocated to the loss component of the liability for remaining coverage applying paragraph 50(b).
(d) the effect of any currency exchange differences on the contractual service margin; and
(e) the amount recognised as insurance revenue because of the transfer of insurance contract services in the period, determined by the allocation of the contractual service margin remaining at the end of the reporting period (before any allocation) over the current and remaining coverage period applying paragraph B119.

B96 For insurance contracts without direct participation features, paragraph 44(c) requires an adjustment to the contractual service margin of a group of insurance contracts for changes in fulfilment cash flows that relate to future service. These changes comprise:

(a) experience adjustments arising from premiums received in the period that relate to future service, and related cash flows such as insurance acquisition cash flows and premium-based taxes, measured at the discount rates specified in paragraph B72(c).

(b) changes in estimates of the present value of the future cash flows in the liability for remaining coverage, except those described in paragraph B97(a), measured at the discount rates specified in paragraph B72(c).

(c) differences between any investment component expected to become payable in the period and the actual investment component that becomes payable in the period. Those differences are determined by comparing (i) the actual investment component that becomes payable in the period with (ii) the payment in the period that was expected at the start of the

period plus any insurance finance income or expenses related to that expected payment before it becomes payable.

(ca) differences between any loan to a policyholder expected to become repayable in the period and the actual loan to a policyholder that becomes repayable in the period. Those differences are determined by comparing (i) the actual loan to a policyholder that becomes repayable in the period with (ii) the repayment in the period that was expected at the start of the period plus any insurance finance income or expenses related to that expected repayment before it becomes repayable.

(d) changes in the risk adjustment for non-financial risk that relate to future service. An entity is not required to disaggregate the change in the risk adjustment for non-financial risk between (i) a change related to non-financial risk and (ii) the effect of the time value of money and changes in the time value of money. If an entity makes such a disaggregation, it shall adjust the contractual service margin for the change related to non-financial risk, measured at the discount rates specified in paragraph B72(c).

BC235 The Board also considered the treatment of investment components. The Board did not regard as useful information, for example, the recognition of a gain for a delay in repaying an investment component accompanied by a loss that adjusts the contractual service margin for the expected later repayment. Acceleration or delay in repayments of investment components only gives rise to a gain or loss for the entity to the extent that the amount of the repayment is affected by its timing. Also, IFRS 17 does not require an entity to determine the amount of an investment component until a claim is incurred (see paragraph BC34). Accordingly, when a claim is incurred, IFRS 17 requires an entity to determine how much of that claim is an investment component, and whether it was expected to become payable that period. IFRS 17 requires any unexpected repayment of an investment component to adjust the contractual service margin. The contractual service margin will also be adjusted for changes in future estimates of cash flows which will include (but not separately identify) the reduction in future repayments of investment components. This achieves the desired result of the net effect on the contractual service margin being the effect of the change in timing of the repayment of the investment component. [Footnote]

Footnote to BC235: Paragraph B96(c) of IFRS 17 requires changes in fulfilment cash flows that arise from differences between any investment component expected to become payable in the period and the actual investment component that becomes payable in the period to adjust the contractual service margin. In June 2020, the Board amended IFRS 17 to specify that paragraph B96(c) of IFRS 17 does not apply to insurance finance income or expenses that depict the effect on the investment component of the time value of money and financial risk between the beginning of the period and the unexpected payment or non-payment of the investment component.

IASB Staff Paper May 2020 AP2A

Para. 5 Paragraph B96(c) of IFRS 17 sets out requirements for the effects of investment components unexpectedly paid or unexpectedly not paid. For example, it requires an entity to determine whether an investment component that was paid in a period was expected to be paid in that period. If it was not expected to be paid, there will be two effects:

(a) the unexpected payment in the period; and

(b) a reduction in the expected cash outflows in future periods. [1]

[1]The alternative situation would be for an investment component that was expected to be paid in the period, not to be paid. In that case, the two effects would be (a) the unexpected lack of a payment in the period and (b) an increase in the expected cash outflows in future periods.

Para. 6 Paragraph B96(b) of IFRS 17 requires the effect described in paragraph 5(b) of this paper to adjust the contractual service margin. Paragraph BC235 of the Basis for Conclusions on IFRS 17 explains that the Board did not think it would provide useful information for a gain or loss to be recognised for the effect described in paragraph 5(a) of this paper and a corresponding decrease or increase in the contractual service margin for the effect described in paragraph 5(b) of this paper. Hence, paragraph B96(c) of IFRS 17 requires the effect described in paragraph 5(a) of this paper also to adjust the contractual service margin.

Para. 7 Between the beginning of the period and the unexpected payment or non-payment of the investment component, the investment component will be affected by the time value of money and may be affected by financial risk and changes in the time value of money and financial risk. Those effects might be as expected at the beginning of the period, or might differ from that expected at the beginning of the period. In either case, the effects should be recognised as insurance finance income or expenses, and should not adjust the contractual service margin. The amendment proposed in the 2019 Exposure Draft Amendments to IFRS 17 was intended to clarify that treatment of these effects.

Para. 8 However, feedback has indicated that the wording in the Exposure Draft is confusing. The staff therefore recommend a change to the wording so that the intention is clear.